12.3 CORPORATE TAX PLANNING

The avid goal of every taxpayer is to minimize his Tax Liability. To achieve this objective taxpayer may resort to following Three Methods :

- Tax Planning
- Tax Avoidance
- Tax Evasion

Tax Planning

Tax Planning is an exercise undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions, etc., to reduce income.

Tax planning can be defined as an arrangement of one's financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, allowances and rebates so that tax liability reduces to minimum. In other words, all arrangements by which the tax is saved by ways and means which comply with the legal obligations and requirements and are not colorable devices or tactics to meet the letters of law but the spirit behind these, would constitute tax planning.

Tax Planning involves planning in order to avail all exemptions, deductions and rebates provided in Act. The Income Tax law itself provides for various methods for Tax Planning, Generally it is provided under exemptions u/s 10, deductions u/s 80C to 80U and rebates and relief's. Some of the provisions are enumerated below :

- Investment in securities provided u/s 10(15). Interest on such securities is fully exempt from tax.
- Exemptions u/s 10A, 10B, and 10BA
- Residential Status of the person
- Choice of accounting system
- Choice of organization.

Short Range and Long Range Tax Planning

Tax planning may be classified into two broad heads: short range tax planning and long range tax planning. Short range tax planning may be the same as year to year planning to achieve a specific or limited objective. For example, an employee whose income is likely to register an unusual growth in a particular year as compared to the preceding year, might plan to subscribe to the PPF/NSC with- in the prescribed limits in order to enjoy substantive tax relief.

In the case of long range tax planning, each tax payer should identify and specify his long term financial objectives. Long term goals must be flexible enough to adapt changes as well as strong enough to accommodate short term plans. The long range planning sometimes may not even confer immediate tax benefits. It aims at a long future period, the benefit of which may be spread over a number of years in future.

Methods Of Tax Planning

Various methods of Tax Planning may be classified as follows :

1. **Short Term Tax Planning :** Short range Tax Planning means the planning thought of and executed at the end of the income year to reduce taxable income in a legal way.

   Example : Suppose, at the end of the income year, an assessee finds his taxes have been too high in comparison with last year and he intends to reduce it. Now, he may do that, to a great extent by making proper arrangements to get the maximum tax rebate u/ s 88. Such plan does not involve any long term commitment, yet it results in substantial savings in tax.

2. **Long Term Tax Planning :** Long range tax planning means a plan chaled out at the beginning or the income year to be followed around the year. This type of planning does not help immediately as in the case of short range planning but is likely to help in the long run;

   e.g. If an assessee transferred shares held by him to his minor son or spouse, though the income from such transferred shares will be clubbed with his income u/s 64, yet is the income is invested by the son or spouse, then the income from such investment will be treated as income of the son or spouse. Moreover, if the company issue any bonus shards for the shares transferred , that will also be treated as income in the hands of the son or spouse.

3. **Permissive Tax Planning :** Permissive Tax Planning means making plans which are permissible under different provisions of the law, such as planning of earning income covered by Sec.10, specially by Sec. 10(1), Planning of taking advantage of different incentives and deductions, planning for availing different tax concessions etc.

4. **Purposive Tax Planning :** It means making plans with specific purpose to ensure the availability of maximum benefits to the assessee through correct selection of investment, making suitable programme for replacement of assets, varying the residential status and diversifying business activities and income etc.

Objective of Tax Planning

(a) Reduction of tax liability

(b) Minimization of litigation

(c) Productive investment

(d) Reduction in cost

(e) Healthy growth of economy

(f) Employment generation

Importance of Tax Planning

One cannot deny the fact that tax planning is important to curtail or reduce the tax liability. Tax planning is also important because of the following factors:

(i) Assesse can avail the benefit of relief, deductions, rebate up to the date of submission of return. These cannot be claimed at the time of appeal. As decided in the case "CIT V. Gurjart gavures Ltd. (1972) 84 ITR 723" that if there is no tax planning and there are lapses on the part of the assesse, the benefit would be the least.

(ii) Tax planning exercise is more reliable since the Companies Law and other laws narrow down the scope for tax avoidance and tax evasion and driving the tax payers to a situation where the person will be free from all severe penal consequences.

(iii) In order to encourage the programs of public interest and good for civilized society, the Government provides incentives in the tax laws. Hence, a planner has to be well versed with the law concerning incentives.

(iv) Because of progressive rate of tax to an individual and Hindu Undivided Family assesse is supposed to pay more tax, if income is increased and it necessitates the devotion of adequate time on tax planning.

(v) Tax planning enables companies to make proper expenses planning, capital budgeting planning, sales promotion planning etc. to reduce the tax planning specially during inflation.

(vi) Now-a-days when credit squeeze and dearmoney conditions, even a rupee of tax decently saved may be taken as an interest free loan from the Government, which perhaps, an assesse need not repay.

(vii) An organization always requires repairs, renewals, modernization and replacement of plants and machineries for continuous growth and to fight with competition. Any decisions of these kind would involve huge capital expenditure, in which is financed generally by ploughing back of profits, reserves. Availability of profits, reserves and surplus and claiming such expenses as revenue expenditure are possible through proper implementation of tan planning techniques.

Difference Between Tax Planning and Tax Management

Tax Planning	Tax Management
(i) The Objective of Tax Planning is to minimize the tax liability	The objective of Tax Management is to comply with the provisions of Income Tax Law and its allied rules.
(ii) Tax Planning also includes Tax Management	Tax Management deals with filing of Return in time, getting the accounts audited, deducting tax at source etc.
(iii) Tax Planning relates to future.	Tax Management relates to Past ,. Present, Future. Past – Assessment Proceedings, Appeals, Revisions etc. Present – Filing of Return, payment of advance tax etc. Future – To take corrective action
(iv) Tax Planning helps in minimizing Tax Liability in Short-Term and in Long Term.	Tax Management helps in avoiding payment of interest, penalty, prosecution etc.
(v) Tax Planning is optional.	Tax Management is essential for every assessee.

Tax Evasion

It refers to a situation where a person tries to reduce his tax liability by deliberately suppressing the income or by inflating the expenditure showing the income lower than the actual income and resorting to various types of deliberate manipulations.

An assesses guilty of tax evasion is punishable under the relevant laws. Tax evasion may involve stating an untrue statement knowingly, submitting misleading documents, suppression of facts, not maintaining proper books of accounts of income earned (if required under the law) omission of material facts in assessments etc.

An assesses who dishonestly claims the benefit under the statute by making false statements, would be guilty of tax evasion.

A tax evader reduces his taxable income by one or more of the following steps :

(a) Unrecorded sales.

(b) Claiming bogus expenses, bad debts and losses etc.

(c) Charging personal expenses as business expenses, e.g., car expenses, telephone expenses, travelling expenses, medical expenses incurred for self or family may be shown in the account books as business expenses.

(d) Submission of bogus receipts for charitable donations for claiming deduction u/s 80G.

(e) Non-disclosure of capital gains on sale of asset.

(f) Non-disclosure of income from 'Benami transactions'.

Types of Tax Evasion

After the researcher definition of tax evasion and characteristics of tax evasion, in this section he will study types of tax evasion.

Tax evasion is more than one type, so from our point of view, types of tax evasion are Tax evasion, according to the standard size.

In this kind of tax evasion, there are two types of tax evasion, micro tax evasion, and macro tax evasion.

(a) **Micro Tax Evasion :** In such case, taxpayers don't pay tax due because they don't declare their income, in this case when the taxpayers completely hide their economic activities or some of their economic activities- Hide economic, black economic, underground economic, smuggling- and taxpayers don't inform tax administrations about their business. All of those are examples of micro tax evasion.

(b) **Macro Tax Evasion :** In such a case taxpayer might follow one of the methods of tax evasion, hide some business subject of tax, or follow the way of fraud and trickery in order to reduce taxes due, In this case taxpayers pay amount less than due amount due. For example hide capital gains when account tax liability, or over report expenditures or deductible or underreport income, sales, these are macro tax evasion.

Tax Avoidance

Tax avoidance is the legal utilization of the tax regime to one's own advantage, in order to reduce the amount of tax that is payable by person and it is very much within the law. In contrast, tax evasion is the general term for efforts made a person not to pay taxes by illegal means.

The avoidance is a kind of art of dodging tax without actual breaking the law. The classic description of tax avoidance was written by Judge Learned Hand in Helvering v. Gregory according to him a transaction, otherwise within an exception of the tax law, does not lose its immunity, because e it is actuated by a desire to avoid, or, if one choose, to evade, taxation.

Methodology of Tax Avoidance

(a) **Income Splitting :** The splitting of income between more than one taxpayer preferably among the family members, so as to reduce the marginal rate of tax chargeable thereon

(b) **Income or Asset Shifting :** This technique is achieved through the shifting of income or income producing asset to another person or entity in which the taxpayer has a beneficial interest and which is chargeable to less tax.

(c) **Deferment of Tax Liability :** Taxpayers sometimes use devices such as issuing loans or in dealing with assets, dispose of them by way of non-taxable dispositions, to effect deferral until sometime in future, the payment of tax on income currently being earned.

(d) **Sheltering of Income :** There are numerous sheltering techniques evolved by the smart assesses which reduces their tax liability, for example, maintaining head offices in 'tax heaven' countries, using domestic tax scheme to the maximum extent by taking deduction which are generally available to mining and agricultural sectors, investment allowances.

(e) **Conversion of Taxable Income into Capital :** This is the capitalization of income means the conversion of otherwise taxable income into capital which may remain untaxed or taxed at a lesser rate; or into some form of intangible benefit to the recipient, the receipt of which will be untaxed; or into some form of income otherwise exempt from tax by the provision of the Act. For example, letting the property on lease at a large premium and much reduced rent.

(f) **Conversion of Capital Expenditure into Current Expenses :** Sometimes taxpayers may arrange for ordinary expenditure to be made in a form which qualifies as a deduction. For example arrangement made by the company to allow the Director to go on business trip with family which is in fact a vacation

(g) **Dividend Stripping :** There are different techniques which reduces the amount of dividend thereby that tax liability will reduce. For example, a solvent company is bought by a shareholding Company, then a large dividend is declared and shares sold at a less than market value (loss) to the former shareholders which than is used as a basis for tax refund claim.

(h) Country of Residence : One way a person or company may lower their taxes due is by changing one's tax residence to a tax haven, such as Monaco, or by becoming a perpetual traveler. However some countries, such as the U.S., tax their citizens, permanent residents, and companies on all their worldwide income. In these cases, taxation cannot be avoided by simply transferring assets or moving abroad.

(i) Double Taxation : Most countries impose taxes on income earned or gains realized within that country regardless of the country of residence of the person or firm. Most countries have entered into bilateral double taxation treaties with many other countries to avoid taxing nonresidents twice -- once where the income is earned and again in the country of residence however, there are relatively few double-taxation treaties with countries regarded as tax havens.

(j) Other Methods : The purchase of an insolvent company which has made heavy loss so as to use the loss against future profits, or the forming of an estate at a loss while it is steadily improved so that it ultimately it sells for a nice capital profit. Arrangements between employer and employee which prejudice the Income Tax Department. For example, by changing the form of certain payment so as to put it outside the tax orbit.

The Difference Between Tax Avoidance and Tax Evasion

Tax Avoidance	Tax Evasion
(i) Where the payment of tax is avoided though by complying with the provisions of law but defeating the intension of the law is known as tax Avoidance.	Where the payment of tax is avoided through illegal means or fraud is termed as tax evasion.
(ii) Tax Avoidance is undertaken by taking advantage of loop holes in law	Tax evasion is undertaken by employing unfair means
(iii) Tax Avoidance is done through not mollified intention but complying the provision of law.	Tax Evasion is an unlawful way of paying tax and defaulter may punished.
(iv) Tax Avoidance looks like a tax planning and is done before the tax liability arises.	Tax evasion is blatant fraud and is done after the tax liability has arisen.

Difference between Tax Planning, Tax Avoidance and Tax Evasion

Tax Planning	Tax Avoidance	Tax Evasion
Legal	Lega	Illegal
Ethical	Unethical	Unethical
No intention to defeat legal spirit	Intention to defeat legal spirit	Intention to defeat legal spirit
By taking legitimate benefits of Income tax law	By taking benefit of loopholes of law	Misstatement annd falsification of accounts, incomes and expenses
No Litigation in courts	Leads to litigation in courts	Leads to litigation in courts
No Penalty/Prosecution	No Penalty/Prosecution	Attracts penalty/prosecution
Good for National Development/Society…creates	It is evil for Nation/Society	It is evil for Nation/Society
Promotes professionalism and strengthens economic and political situation	Encourages bribery and weakens economic and political situation	Enncourages bribery and weakens economic and political situation

Minimum Alternative Tax (MAT) (u/s 115JB)

MAT stands for Minimum Alternate Tax and AMT stands for Alternate Minimum Tax. Initially the concept of MAT was introduced for companies and progressively it has been made applicable to all other taxpayers in the form of AMT.

The concept of MAT was introduced to target those companies that make huge profits and pay dividend to their shareholders but pay no/minimal tax by taking advantage of the various deductions, and exemptions allowed under income tax act. But with the introduction of MAT, the companies have to pay a fixed percentage of their profits as Minimum alternate Tax. MAT is applicable to all the companies including foreign companies.

MAT is calculated u/s 115JB of the income tax Act. Every company should pay ***higher*** of the tax calculated under the following two provisions:

1. Tax liability as per the **Normal provisions** of income tax act(tax rate 30% plus 3% Edu. cess plus surcharge (if applicable)
2. Tax liability as per the **MAT provisions** given in Sec 115JB(18.5 % of Book Profits Plus 3 % Edu cess plus surcharge if applicable)

MAT is equal to 18.5% of Book profits (Plus Surcharge and cess as applicable). Book profit means the net profit as shown in the profit and loss account for the year as increased and decreased by following items :

Additions to the Net Profit (If debited to P/l A/c)

1. Income Tax paid or payable if any calculated as per normal provisions of income tax act.
2. Transfer made to any reserve
3. Dividend proposed or paid
4. Provision for loss of subsidiary companies
5. Depreciation including depreciation on account of revaluation of assets
6. Amount/provision of deferred tax
7. Provision for unascertained liabilities e.g. provision for bad debts
8. Amount of expense relating to exempt income u/s 10,11,12 (except sec 10AA and 10(38) (It means income u/s 10AA and long term capital gain exempt u/s 10(38) are subject to MAT).

Deletions to the Net Profit (If credited to P/L A/c)

1. Amount withdrawn from any reserves or provisions
2. The amount of income to which any of the provisions of section 10, 11 and 12 except 10AA and 10(38) apply.
3. Amount withdrawn from revaluation reserve and credited to profit and loss account to the extent of depreciation on account of revaluation of asset.
4. Amount of loss brought forward or unabsorbed depreciation, whichever is less as per the books of account. However loss shall not include the depreciation. (if loss brought forward or unabsorbed depreciation is nil then nothing shall be deducted.)
5. Amount of Deferred Tax, is any such amount is credited in the profit and loss account
6. Amount of depreciation debited to P/l A/c (excluding the depreciation on revaluation of Assets)

Mat Credit

When any amount of tax is paid as MAT by the company, then it can claim the credit of such tax paid in accordance with the provision of section 115JAA.

Allowable Tax Credit = Tax paid as per MAT calculation – Income tax payable under normal provision of Income tax Act, 1961.

Tax Consideration in Specific Business Decision

The fundamental purpose of any tax system is to raise revenue for government. Therefore, it's important to view tax proposals first through the lens of what makes a good public finance system. Over years of research and practical experience, the MCFE has advocated several concepts and principles to guide decision-makers and inform governments as to how to best tax their citizens.

It should be noted that "good tax policy" does not change during times of large budget deficits or healthy surpluses. Good tax systems can fall woefully short of creating adequate revenue during recessions, and poor tax systems can raise plenty of money (but they often are unsustainable).

MCFE encourages policymakers and tax practitioners to focus on designing a system based on good tax principles first, and then assess how that system can best raise revenue adequate to meet public demands for service.

"Tax fairness" is the idea most people gravitate towards when thinking about good tax principles, but the emphasis placed on this issue is often so great it appears fairness is the only tax concept that matters. Of all the principles of good tax policy, fairness is the most challenging to put in place since it means different things to different people. It is also the tax principle that has made the most obvious leap from the world of economics into the rhetoric of politics, meaning policymakers are often comparing apples and oranges when they debate the fairness of competing tax proposals.

Principle of Good Tax Consideration

(a) **Keep Taxes Simple, Easy to Comply with, and Easy to Collect :** The more complex a tax, the greater the costs for the government to administer it and the greater the compliance costs for taxpayers to determine their liability and report it. Simplicity also breeds a sense of fairness among taxpayers due to greater understanding.

(b) **Make Taxes Transparent and Visible :** Taxpayers should know that a tax exists, why the tax is being levied, who's responsible for the tax, and how it's calculated and paid. As a matter of economics, when taxes are visible it allows citizens to make informed judgments about the relationship between their tax burden and the types and levels of government services provided to them. Ensuring that taxpayers "feel" their tax burdens helps ensure that government remains accountable to its citizens.

(c) **Encourage Stability and Predictability :** Both taxpayers and governments benefit from stability and predictability in tax systems. Taxpayers need stability in order to plan for payments. If they have no idea what level of tax they will be paying, they cannot plan their budgets well.

Stability in revenue collection can encourage more stable spending patterns. Since different types of taxes are affected differently by changes in the economy, stability is best achieved by avoiding an overreliance on any one revenue source.

(d) **Don't Distort Decision-Making :** All taxes influence decision-making to some extent, but the effect of tax law on personal and business decisions should be kept to a minimum. As tempting as it is to try to encourage various social and economic outcomes through the tax code, markets normally allocate resources more effectively than government action.

(e) **Protect Economic Competitiveness :** A tax system needs to reflect the realities of competing in a global economy. Information technologies and other advances are reducing the significance of "place" in the conduct of economic activity. No state can afford to ignore this by placing themselves at a distinct comparative disadvantage relative to other states. Tax systems should also be responsive to changing regulatory and competitive circumstances.

(f) **When Possible and Appropriate, base Taxes on Benefits Received :** Policy makers should always strive to enact fees or taxes that are directly related to the costs of the benefits provided to the people paying them. Of course, most government services are more general in nature and broadly beneficial to society as a whole, which means they can't readily be tied to identifiable taxpayers or groups of taxpayers. Consequently, most government services require general taxation and the consideration of other tax principles.

Tax Consideration in Specific Business Decision

1. Make or Buy
2. Own or Lease
3. Retain or Replace
4. Export or Domestic Sales
5. Shut down or Closure
6. Expand or Contract
7. Invest or Disinvest

1. Make or Buy

This applies to industries where assembly of products takes place to make a finished product. Like a manufacturing of car, where thousands of different parts or components are assembled to make a car.

It is quite natural every components or part of a car cannot be manufactured by one company. Since part manufacture involves cost, time, energy, and different kinds of technology and expertise. Therefore, in such cases company purchases parts from outside agencies. But where the cost involved in purchasing from outside market is high, then the company might go in for in house production.

Apart from costing consideration following factors also go in decision-making process :

1. Utilizations of Capacity
2. Inadequacy Fund
3. Latest Technology
4. Dependence of supplier
5. Labor problem in the factory

What are the cost involved in making of a pat :

1. Fixed Cost : Purchased of Plant etc.
2. Variable Cost : Raw Materials, Labour, Electricity etc.

What are the cost involved in buying of a part from outside agency :

1. Buying Cost
2. Inventory Cost

Comparison of the above tow cost shall determine which decisions the company shall follow. But, however it should be kept in mind that while comparing Cost, common cost should not be taken into account.

It should also be noted that the cost incurred in making a product and buying a product, both involves incurring of revenue expenditure. Therefore, tax saved in both the cases are same. It comes into picture only when there is a need for extension or establishment of new unit to manufacture that new components.

Tax Consideration

1. **Establishing a New Unit :** If the decision to manufacture a part or component involves a setting up a separate industrial unit than tax incentives available u/s 10A, 10B, 32, 80IA and 80IB should be considered.
2. **Export :** If 'Make or Buy' decision is taken for exporting goods then tax incentives available u/s 80HHC depends upon whether goods manufactured by taxpayer himself are exported or goods manufactured by others are exported by the taxpayers.
3. **Sale of Plant and Machinery :** If buying is cheaper than manufacturing and the assessee decides to buy parts or components for along period of time, he may like to sell the existing plant and machinery. Tax implication as specified by Sec. 50 has to considered.

2. Own or Lease

Concept of leasing is gaining immense popularity. One private airline has recently sold and taken back the same aircraft on lease. In the process it got some fund in its account. One factor which influenced its decision was that the lease rental paid to foreign enterprise is not subject to withholding tax if the lease agreement has been approved by the Central Government. Other factors which must be considered for tax implications are that in case of buying the asset, the assessee will be entitled to deduction on the account of depreciation and interest, while in case of lease he will be entitled to deduction on account of lease rental which will be higher in the initial years. Hence, tax consideration will also influence management decision to own or lease.

3. Retain and Replace Decision

One important Decision which involves alternative choice is whether or not to buy new capital equipment. Both have their own merits and demerits. Generally replacement offers cost saving which results in increase in profits. But replacement required investment of large funds resulting in extra cost. The decision is based on the relative profitability and other financial and non-financial consideration. Tax consideration should also be taken into account in this context. Some of the important consideration from tax angle to which attention will have to paid. Relate to allowance of deprecation as also the allowance on account expenditure on scientific research. The applicability of the provision for allowances should be considered and their impact ascertained before any decision is taken.

4. Export or Domestic Sales

The current Indian government has an aim of increasing the output and the quality of exports from India as portrayed by the "Make in India" policy, and the many tax benefits provided to the exporters. GST rolled out on July 1 and yet there is still some ambiguity among the exporters on the possible impact of the new regime on this industry. Traders want to know how GST will affect the products exported, and the amount of tax paid on the raw material/input used.

Trade taxes can also generate indirect (or unintended) effects on economic activity. Trade taxes, for instance, can be the source of smuggling, and evasion of taxes can occur either for imports or exports.

Smuggling represents socially wasteful activity in which real resources are used to avoid payment of the tax; in effect, tariff revenues that would otherwise accrue to the government are now dissipated in real resources devoted to smuggling. Smuggling, in turn, can coexist with corruption, where again real resources are devoted to evasion of taxes, either by bribing officials or by mis-invoicing and other related schemes. Relative to smuggling, bribery can be a more efficient outcome insofar as tariff revenues are transferred as payment to officials, and benefits accrue to bribers in the form of profits from resale of lower cost imports.

Beyond the role of taxes as a determinant of trade, it is also important to understand the effects various kinds that taxes themselves have on trade. For the purposes of the discussion here, I will divide tax effects linked to trade into direct effects associated with explicitly trade-related taxes, and indirect effects derived from the collection of non-trade taxes. Trade related taxes refer to tariffs collected on imports, and export taxes (or subsidies; negative taxes) collected as exports leave a country. These are all measures directly administered at the national border. Non trade taxes are the much larger and more revenue significant taxes such as income, corporate, sales, VAT, OR GST excise, social security, property and other taxes.

Trade Taxes with Multiple Goods

Trade taxes can also have further effects where rates vary by commodity. If tariffs or export taxes apply at different rates to different commodities, they will affect the composition as well as the volume of trade.

Impact on The Non-Traded Goods Structure

Trade taxes also have the effect of diverting economic activity into the non-traded goods sector and hence further reducing the volume of trade. The non- traded goods sector comprises several key service items, such as retail and wholesale trade, as well as government, professional and other services.

5. Shut Down or Closure

A firm may decide to implement a **shutdown** of production when the revenue from the sale of the goods/services cannot cover the fixed costs of production. In that situation, the firm will experience a higher loss when it produces, compared to not producing at all.

While taking a decision whether to continue the business or shut down the operations, it is to be remembered that non-speculative business loss can be carried forward and set-off for a maximum period of 8 years. So, before shutting down the operations, an assesses must not forget that non speculative business loss (if any) will lapse.